February 2015

Accounting for revenue is changing

Impact on housebuilders

Have you planned for the effects on:

- sales of completed units?
- sales of incomplete units or off-plan purchases?
- sales with part exchange?
- sales with help to buy?
- sales with extras?
- amenities specified in contract conditions?
- sales of multiple units?
- contract modifications?
- warranties?
- up-front payments?
- new disclosures?
- transition options?

How could your business be affected?

Now that the IASB and FASB have published a new joint standard on revenue recognition, the real work for housebuilders is just beginning. IFRS 15 *Revenue from Contracts with Customers* was issued in May 2014, replacing most existing IFRS revenue guidance, and introducing a new revenue recognition model.

The new standard could impact the top line for housebuilders and the related communications with investors. Companies need to assess how their financial reporting, information systems, processes and internal controls will be affected. In addition, the new disclosure requirements are extensive and might require changes to systems, processes and internal controls to collect the necessary data. Companies will need to engage with their investors and other stakeholders to establish expectations of how their key performance indicators or business practices may change as a result of the new standard.

The new standard takes effect in January 2017, although IFRS preparers can choose to apply it earlier. While the effective date may seem a long way off, decisions need to be made soon – especially regarding when and how to transition to the new standard. An early decision will allow you to develop an efficient implementation plan and inform your key stakeholders.

Determining the impact

<table>
<tr><th></th><th>Potential impact</th><th>Actions to consider</th></tr>
<tr><td>Sales of completed units</td><td>Under IFRS 15, revenue is recognised only when a contract is in the scope of the standard – i.e. when the contract is legally enforceable and certain other criteria are met.
If a contract does not meet the specified criteria, then any consideration received from the buyer is recognised as a liability until the criteria are met.
Similar to current practice, revenue for the sale of units that are completed before the housebuilder enters into a contract with a buyer is likely to be recognised at a point in time; however, this timing will be determined based on the transfer of control rather than the transfer of the significant risks and rewards of ownership. Judgement may be required to determine the point in time at which control transfers as various indicators may be met at different points in time – e.g. a buyer can be exposed to the risks and rewards of ownership prior to obtaining physical possession of the house.</td><td>Review contractual terms and consider relevant laws and regulations to determine at what point in time a contract meets the specified in-scope criteria.
Exercise judgement in determining the point in time at which control of a house transfers to the buyer.
Revise existing accounting policies as necessary and develop accounting procedures to ensure consistency of application.</td></tr>
<tr><td>Sales of incomplete units or off-plan purchases</td><td>IFRS 15 introduces new criteria to determine whether and when revenue should be recognised over time. Housebuilders will need to determine if the buyer controls the asset as it is created or enhanced – e.g. work in progress may transfer to the buyer as a new house is constructed.
In some cases, it may not be clear if a buyer controls the property as it is constructed, and a housebuilder will need to evaluate whether:
its performance creates an asset with no alternative use to it due to contractual or practical restrictions – e.g. a particular unit/location has been clearly identified and assigned specifically to the buyer; and
it has an enforceable right to payment for performance completed to date.
If both of these conditions are met, revenue will be recognised over time, using a method that depicts performance. This may bring revenue recognition forward for some cases in which revenue is currently recognised on completion.
Applying this guidance will require careful consideration of the specific facts and circumstances of each case and potentially include legal consultation in certain jurisdictions.</td><td>Evaluate contracts against the new criteria to determine whether revenue should be recognised over time or at a point in time.
Identify commercial opportunities by reconsidering whether any contract terms or business practices should be modified for the impact of IFRS 15.
Develop the processes, systems and internal controls needed to recognise revenue over time rather than at a point in time.</td></tr>
<tr><td>Sales with part exchange</td><td>Some homebuilders allow a buyer to trade their existing home as part of the consideration for a new home – i.e. part exchange.
IFRS 15 requires non-cash consideration received from a customer to be included in revenue and measured at fair value, but does not provide explicit guidance on the measurement date. As the fair value of a part-exchanged property may change between contract inception and fulfilment, judgement may be required to determine the amount of revenue.
Under the new standard, the subsequent sale of the property received as non-cash consideration will be accounted for as a separate contract with another customer resulting in revenue from that separate transaction. This may be a change to current practice and affect the margin because the margin earned on a second-hand home may be lower than on a new build home.
Sales incentives that do not involve a separate good or service will often represent variable consideration under IFRS 15 and so be included in the transaction price – i.e. reflected in revenue not cost of sales.</td><td>Consider the impact of part-exchange sales on revenue and specifically on margins.
Exercise judgement in determining the measurement date of the fair value of the property received as non-cash consideration.
Assess any required changes to existing systems to track and record sales of part-exchanged properties as separate contracts.
Determine if revisions are needed to accounting procedures in order to include estimated sales incentives in the transaction price.</td></tr>
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	Potential impact	Actions to consider
Sales with help to buy	• In some jurisdictions, government-backed schemes are available to assist certain homebuyers with the purchase of a home – e.g. the UK government has introduced the equity loan and mortgage guarantee schemes that allow a buyer to purchase a home with a deposit as low as 5%. • Depending on the structure and contractual terms of transactions where help to buy is provided as part of the house purchase contract, a housebuilder may need to evaluate whether the government agency is a collaborator or partner that shares in the risk and rewards of the transaction. • IFRS 15 excludes from its scope contracts with a collaborator or a partner that are not customers.	• Evaluate whether a government agency that provides help to buy a home is a customer under the new standard.
Sales with extras	• A contract for a sale of a house may specify customer requirements or include extra fixtures or fittings. • IFRS 15 includes detailed new requirements on how to determine whether the various goods or services promised in a contract – e.g. white goods, carpets, design upgrades – are distinct and therefore accounted for as separate performance obligations. • Judgement will be required when applying the indicators to specific facts and circumstances, particularly in evaluating whether the 'extras' are distinct in the context of the contract. • If separate performance obligations are identified, then a housebuilder allocates the total transaction price to each performance obligation based on the relative stand-alone selling prices of the goods or services and recognises revenue for each of them as they are satisfied.	• Identify types of extras that are typically provided and exercise judgement in determining whether such extras are distinct. • Develop new processes and adjust systems and internal controls to capture, estimate and monitor stand-alone selling prices to allocate the transaction price to the performance obligations in the contract. • Assess whether billing management and related systems, and internal controls are capable of supporting the allocation methodology and generation of journals to allocate revenue.
Amenities specified in contract conditions	• When an individual house is part of a larger new development, the sale contract may specify that the completed development will provide certain amenities – e.g. common areas, roads, street lights or recreation facilities. Such amenities may be completed after the buyers take possession of individual houses. • Consideration will need to be given to whether such conditions affect the revenue recognition for individual units, or are 'extras' to be accounted for as separate performance obligations.	• Consider the impact of amenities specified in contracts on the accounting for the sale of individual units.
Sales of multiple units	• If a developer sells numerous houses to a single customer – e.g. social housing sold to a government-sponsored entity – it will need to consider whether the sale represents multiple performance obligations or a promise to deliver a single development to the customer. • Consistent with the points raised above relating to the sale of incomplete or off-plan units, an assessment will be required to determine when control of the goods or services transfers to the buyer and therefore the timing of revenue recognition.	• Evaluate promised goods or services against the new requirements to identify the performance obligations in the contract. • Exercise judgement in determining when control of a unit(s) transfers to the buyer.
Contract modifications	• IFRS 15 does not include explicit guidance on accounting for contract variations and claims. Instead, it includes general guidance on contract modifications and other changes in the transaction price. • Contract modifications are accounted for either prospectively, if distinct goods or services are added to the arrangement, or by a cumulative catch-up adjustment.	• Identify types of contract modifications that are customary for the business and determine the appropriate accounting treatment. • Develop systems and internal controls to track modifications and methodology to ensure appropriate application.

	Potential impact	Actions to consider
Warranties	• Housebuilders may issue warranties in conjunction with house sales. Under IFRS 15, an entity accounts for a warranty as a performance obligation if the customer has an option to purchase the warranty separately or additional services are provided as part of the warranty ('service-type warranty'). If so, a portion of the transaction price is allocated to the warranty and revenue is recognised as the performance obligation is satisfied. • In contrast, if a warranty is required to be provided by law or solely provides the buyer with assurance that the product complies with agreed-upon specifications in the contract ('assurance-type warranty'), a warranty provision is recognised under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* at the date of sale, for the best estimate of the costs to be incurred for repairing or replacing the defective products.	• Review warranties that are offered or provided with the sale of a house and determine whether they represent service-type or assurance-type warranties. • Determine whether process and system changes are required to identify and account for any service-type warranties.
Up-front payments	• Upon entering into a contract, a customer may pay a deposit that is refundable only if the housebuilder fails to complete construction of the home in accordance with the contract. • Under IFRS 15, revenue from such payments will be recognised when the goods or services to which they relate are transferred to the customer. As such, unless the payment relates to a separate good or service, the pattern of recognition will depend on whether control of the property is transferred at a point in time or over time, which may not coincide with the timing of cash received from the customer. • The timing of receipt of an up-front payment in comparison to the transfer of the goods or services it relates to, may give rise to a significant financing component. Therefore, the transaction price may need to be adjusted to reflect the time value of money, unless the practical expedient not to adjust is applicable and elected by the housebuilder.	• Assess the impact of new guidance on timing of revenue recognition for any up-front payments. • Determine whether the receipt of an up-front payment involves a significant financing component and, if so, whether the practical expedient not to adjust if the payment is made within 12 months of transfer of control of the property applies.
New disclosures	• Extensive new disclosures are required, incorporating both qualitative and quantitative information – e.g. housebuilders will need to provide more detail about performance obligations remaining at the reporting date, including when they expect to satisfy them. There are no exemptions for commercially sensitive information. • Stakeholders and competitors may take a close interest in the new disclosures related to unsatisfied performance obligations which convey information about future activity.	• Perform an initial assessment of whether existing systems and processes can collect the necessary data required to provide the new disclosures.
Transition options	• IFRS 15 may be adopted retrospectively, by restating comparatives and adjusting retained earnings at the beginning of the earliest comparative period. • Alternatively, IFRS 15 may be adopted as of the application date, by adjusting retained earnings at the beginning of the first reporting year.	• Quantify and evaluate the effects of the different transition options, including the available practical expedients under the retrospective approach. • Perform an historical analysis of key contracts. Consider whether existing systems provide the data required to produce comparative information if the new standard is applied retrospectively.

You may also be interested to read …

In the Headlines: Revenue – a new global standard

Provides a high-level three-page summary of significant changes resulting from the new revenue standard together with their impact on entities.

May 2014

First Impressions: Revenue from contracts with customers

Offers a thirty-page digestible summary of the requirements of the new revenue standard and highlights the areas that may result in a change in practice.

June 2014

Transition to the new revenue standard

Helps you to understand the best option for your business when transitioning to the new revenue standard.

June 2014

Issues In-Depth: Revenue from contracts with customers

Pools the detailed insights of KPMG's revenue recognition teams globally to guide you through the new standard over two hundred pages.

September 2014

Impacts on the construction Industry of the new revenue standard

Highlights key areas of potential change for construction industry resulting from the new revenue standard by considering the life cycle of a typical construction contract.

September 2014

Click on the images above to access the publications.

How we can help

KPMG's Building & Construction practice

KPMG's Building & Construction practice is dedicated to supporting housebuilding and construction companies globally in understanding industry trends and business issues. Member firms offer customised, industry-tailored services that can lead to value-added assistance for your most pressing business requirements. Our extensive network of professionals combines in-depth industry knowledge with extensive experience helping clients managing accounting transitions with what they entail.

For those affected by the new revenue recognition requirements, the impact will be felt far beyond accounting change. The following are just a few examples of how KPMG cross-functional team of experts have helped clients across various sectors – including housebuilding and construction – with the accounting and operational challenges.

- Performing an overall impact assessment to identify the key revenue streams that may be impacted by IFRS 15.
- Performing a detailed accounting diagnostic to identify and prioritise the impacts on accounting policies and disclosures, including information gaps.
- Reviewing key accounting policies and accounting manuals.
- Identifying and analysing key contracts under the IFRS 15 lens.
- Assisting in redrafting contract documentation.
- Identifying the impacts to internal management reporting, including key financial measures and ratios.
- Assisting in developing clear communication with stakeholders regarding the impact of IFRS 15 on earnings.
- Mapping information requirements to existing sources and defining required information that is not currently available in the existing systems.
- Identifying data collection needs to meet the new disclosures requirements.
- Assisting in changing systems and processes to meet the new requirements.
- Providing training to finance teams.
- Identifying corporate and indirect tax implications, and impact on distributable reserves.

Starting now will allow you to assess the impact, and design an appropriate response plan that allows time for unanticipated complexity.

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